

NATIONAL FORECAST DESCRIPTION

The Forecast Period is the Fourth Quarter of 2001 through the Fourth Quarter of 2005

Economist can learn a lot from baseball players. One of the best-known sayings by the major league's greatest philosopher, Yogi Berra, is "It ain't over--till its's over." Interestingly, Mr. Berra's timeless wisdom is appropriate to both the baseball diamond and the current economic situation. Late last year the National Bureau of Economic Research (NBER) declared the nation's record decade-long economic expansion ended in March 2001. However, at no time since then has real GDP contracted for two consecutive quarters, which is the economists' rule-of-thumb definition of a recession. As a result, some economists sound more like followers of the former Yankee catcher than their esteemed colleagues at NBER. That is, the economic expansion never ended, but suffered a temporary setback.

If a recession did occur, it was the mildest on record. Assuming the recession started in the second quarter of 2001 and ended in the third quarter, the recession was just two quarters long. This is about half as long as the average recession lasted after World War II. The 0.3% output decline was almost negligible compared to the average contraction of 3.3%. Some may classify the recent slowdown as the second soft landing by the Federal Reserve. Others are fence sitters who have yet to classify our recent economic experience. Fortunately for them, Mr. Berra has another piece of advice. "When you come to a fork in the road—take it."

Oddly enough economists seem to be more in agreement about where the economy is headed than where it has been. Almost everyone agrees the economy is on the mend and growth will accelerate in the near future. Another thing most economists seem to agree on is the prospects for the economy have brightened in recent months. The current DRI*WEFA forecast serves as a good example. As mentioned above, real GDP is expected to have fallen in just the third quarter of last year and real GDP contracted 0.3%. In contrast, last November, DRI*WEFA had projected real GDP would shrink for three consecutive quarters and output would drop 1.0% from peak to drop.

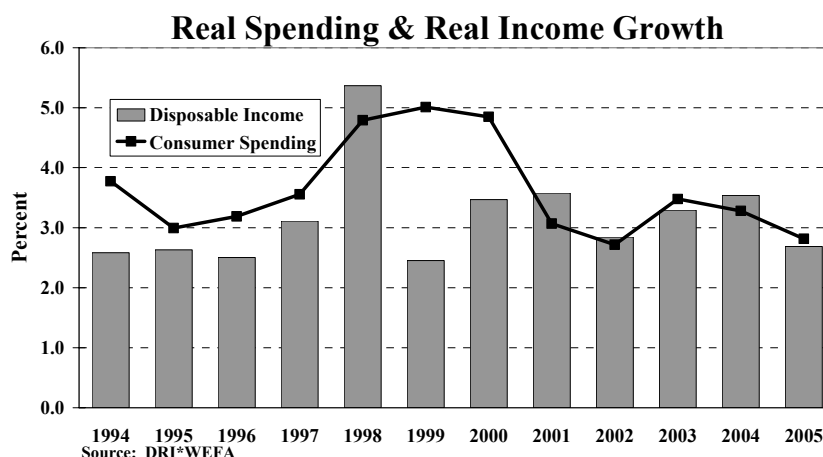
Another way this recession breaks tradition is real GDP is not expected to experience the sharp growth spurt that is typical during the recovery. During a typical recession, spending is put off until the economy improves. In a typical recession, spending goes strongly as pent up demand is satisfied. This contributes to the real GDP spike. But the current recession was not typical. Consumer spending never collapsed, and in fact it helped keep the economy afloat. At the end of this recession, there is little pent up demand to be met. And some of this demand has been satisfied from inventories, which does not count toward current production. After growing 1.6% this year, real GDP is expected to advance 3.8% in both 2003 and 2004, and 3.0% in 2005.

Despite this improvement in real GDP, DRI*WEFA has not changed its national employment forecast significantly. Both forecast show the economy shedding about 1 million jobs from the middle of last year to the middle of this year. Both forecasts agree the manufacturing sector has been hard hit and will take longer than the overall economy to recover. This reflects the collapse in business fixed investment that has hit the manufacturing sector especially hard. This sector should begin adding jobs again in 2003 and continue expanding over the forecast horizon.

SELECTED NATIONAL ECONOMIC INDICATORS

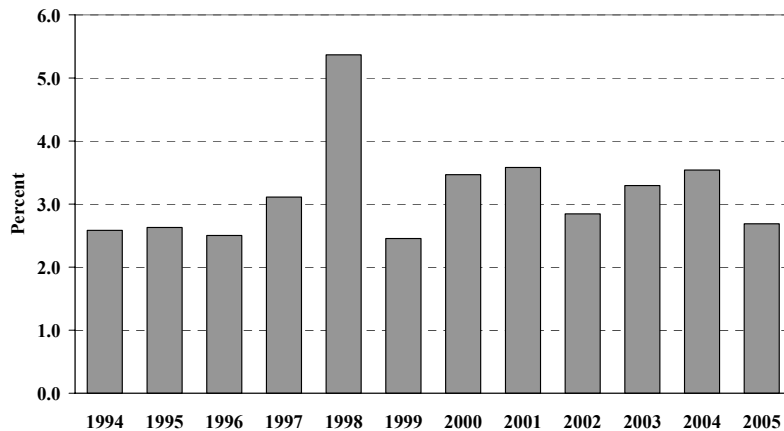
Consumer Spending: Real consumer spending continued to expand during the recession, which helped make the current economic downturn the mildest on record. Interestingly, this also means there is no pent up demand waiting to be unleashed, so the economic recovery should be milder than usual. This can be seen by comparing the 1990-91 recession to the 2001-02 recession. The earlier

recession clearly hit the consumer sector very hard. Real consumer spending dropped 1.3% over the course of the recession, which was virtually the same amount real GDP declined. As a result of consumers' thrift, the savings rate rose and outstanding credit fell. Under these conditions, real consumer spending was ripe for a strong recovery. This did, in fact, occur. Real consumer spending leaped over 6.0% in 1991's first quarter as consumers raced to make purchases that had been postponed during the recession. Thus, after declining 0.2% in 1991, real consumer spending increased almost 3.0% in 1992. In contrast, real consumer spending slowed, but never retreated during the 2001-02 recession. It hit its nadir in the first quarter of 2002 when it grew just 0.8%. (Part of this slowdown reflects a return to a more sustainable pace after the strong 6.0% annual growth in the last quarter of 2001.) Interestingly, this blip barely shows up in the annual data. Specifically, real consumer spending is estimated to have grown 3.1% in 2001 and is forecast to increase 2.7% in 2002. It is amazing that Americans never lost faith in the economy despite suffering major blows on several fronts. The most notable, of course, was the September 11, 2001 terrorists' attack. The severity of the attack has overshadowed other setbacks Americans recently suffered. The stock market correction reduced the net worth of American households over the last two years. This is significant because many economists believe there is a link between increased wealth and increased spending. Thus, a reduction in wealth would cause a reduction in spending. There may also be another connection between wealth and spending. Some feel rising household wealth made consumers feel the stock market was doing their saving for them. As such, consumers were willing to spend more of their income and save less. This helps explain the huge drop in the U.S. personal saving rate in recent years. With the recent reversal of fortune, it was feared Americans would spend less and save more of their income. This has not happened, at least so far. One of the reasons for this is household wealth is falling from record levels, so Americans may still feel rich, even though they are not as wealthy as they were a few years ago. These factors may have caused confidence to wane, but not collapse. In fact, consumers were upbeat enough to take advantage of price discounts and financing incentives for purchasing new vehicles, computers, home furnishings, clothing, and services. Without the boost from pent up demand, real consumer spending growth over the forecast period will likely mirror disposable personal income growth. Specifically, real disposable income is forecast to rise 2.8% in 2002, 3.3% in 2003, 3.5% in 2004, and 2.7% in 2005. Real consumer spending is expected to increase 2.7% in 2002, 3.5% in 2003, 3.3% in 2004, and 2.8% in 2005.



Inflation: Economy watchers will have one less thing to worry about over the next few years. Inflation, a potential bane to an expanding economy, should be benign. There are several reasons for this outlook. First, the recession was very mild by historical standards, so its recovery will likely be mild. Thus, it is unlikely to result in excessive demand pressures that will reignite inflation. The second

Consumer Price Inflation

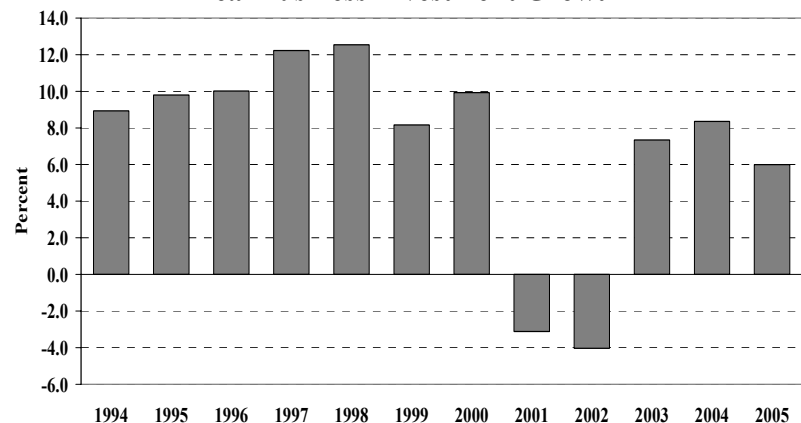


Source: DRI*WEFA

shocks. Fourth, poor profits will also keep inflation in check. To boost their long-suffering bottom lines, businesses will have to control costs. One way for them to do this is to be conservative with employee compensation. Because employee compensation plays such an important role in driving prices, this implies modest increases over the forecast period. Core inflation (inflation less energy and food) should advance just under 3.0% per year. Total inflation is projected to swing above and below the core rate, thanks to notoriously volatile food and energy prices. Energy prices have had the most press attention in recent months. Thanks to subdued demand caused by the mildest winter in history and the soft world economy, the price of oil dropped from nearly \$24/barrel in the third quarter of 2001 to just over \$18/barrel in that year's fourth quarter. At the end of March 2002, the price of oil climbed above \$26/barrel, on fears of disrupted supplies from the Middle East caused by escalating hostilities in the region. Interestingly, this price is well within the range of \$20/barrel to \$30/barrel inflation-adjusted prices that have prevailed since 1986. It is lower than the \$34/barrel price from the winter of 2000-01, and two-thirds lower than the \$75/barrel price during the second oil embargo. A spike of that magnitude would push the economy into a recession, but it is not expected. Consumer prices are forecast to rise 1.8% in 2002 and just over 2.5% annually through 2005.

Business Investment: The strength of the economic recovery will be largely determined by how well real business fixed investment rebounds from its recent collapse. A bit of history is warranted here because of this sector's important role in the recovery. Business investment had been the major engine of economic growth during the nation's longest economic expansion. From 1992 to 2000, real business investment rose an average of 10.0% per year. In comparison, real GDP growth averaged 3.7% over the same period. Investment's strong showing during this time can be traced

Real Business Investment Growth

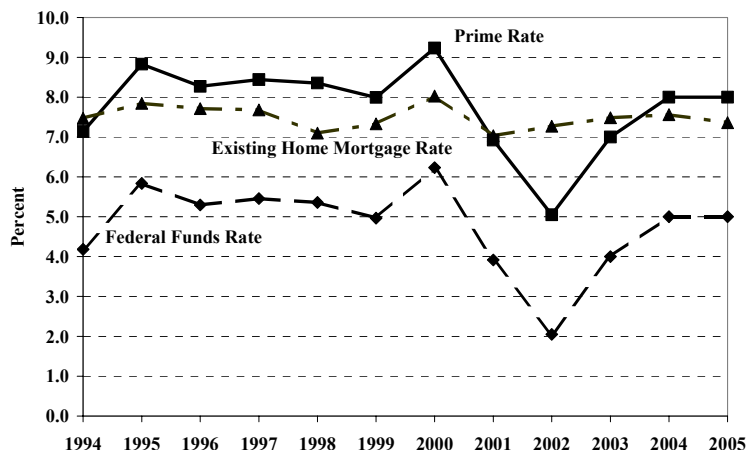


Source: DRI*WEFA

to several factors. Spending on computers and software fueled investment in the early 1990s. Growth accelerated in the mid-1990s with the widespread use of the World Wide Web and the Telecommunications Act of 1996. Another push came when Y2K fears caused companies to upgrade their hardware and software systems. Finally, the dot-com boom fueled further growth. Ironically, it

was the dot-com collapse that caused real business investment to shrink in 2001 for the first time since the 1990-91 recession. Leading the retreat was investment in telecommunications equipment, which declined an estimated 19.6% in 2001. Unfortunately, this sector's woes continue to pile up. Global Crossing is the most recent, notable disaster. In a short time it fell from industry darling to dud when it declared bankruptcy in January 2002. Computer investment declined just 0.7% last year. This is small compared to the plunge in telecommunication equipment spending. However, it is significant because it marks just the second time real investment in computers has declined since this data has been tracked (1967). The other time it declined was in 1990. Computer investment should rebound by nearly 13.0% this year. Unfortunately, this will not be enough to overcome the drag of other business investment sectors. As a result, total real business investment is expected to contract again this year. One of the main reasons for this disappointing outlook is the U.S. and the rest of the world is awash in excess manufacturing capacity. Economists consider manufacturing utilization of 85% to be full capacity. Currently, manufacturing capacity utilization is at 73%, its lowest level since 1983. Companies have little incentive to invest in new equipment when the equipment they already have sits idle. One wild card is the impact the new tax relief bill will have on investment. This bill is designed to boost investment by allowing generous "bonus" depreciation for equipment. It should be pointed out the current forecast does not include the impacts of this tax bill. Real business investment is forecast to grow again beginning next year, as the growing economy steadily whittles down the excess manufacturing capacity. Specifically, real business fixed investment is project to grow 7.3% in 2003, 8.3% in 2004, and 6.0% in 2005. After two years of decline, the projected growth in investment will be welcomed, but it is not anticipated to be nearly as strong as it was in the 1990s.

Selected Interest Rates

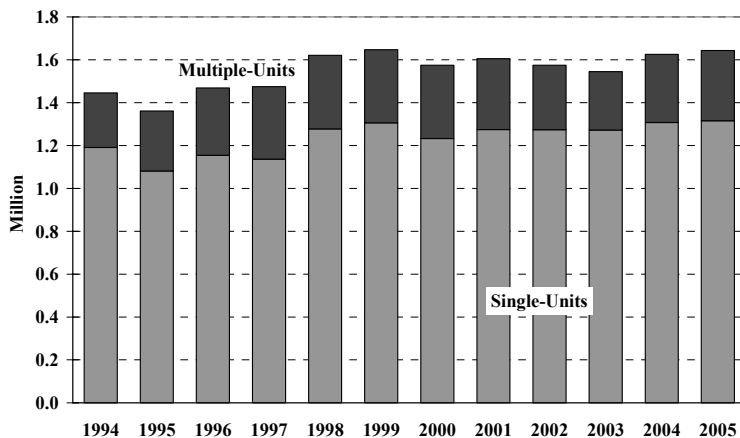


Source: DRI*WEFA

Financial: American monetary policy is in a stage of transition. All of last year the Federal Reserve focused on an accommodating policy that would help the economy skirt a recession. In order to do this, the nation's central bank threw out its traditional gradualist approach and aggressively lowered its bellwether federal funds rate target 11 times from January 2001 to December 2001. Over this period the rate dropped from 6.5% to 1.75. Despite its drastic actions, it appears the Federal Reserve was too close to the deck before it attempted another soft landing. As a result, the economy slipped into a mild

recession. While the rate decreases did not prevent the slowdown, they did help contain the damage and provided stimulus for the recovery. It now appears its day of lowering interest rates are behind it. Instead, the Federal Reserve will take a wait-and-see stance over the next few months to determine the strength over the recovery. The central bank has been afforded the luxury of time because inflation is not a current threat. Thus, the Federal Reserve finds itself in the rare position of not walking the razor's edge between inflation and the economy. The central bank passed on its latest opportunities to change rates during its January and March 2002 meetings. In the statements following those meetings, the Federal Open Market Committee clearly felt the economy was on the mend and further loosening was unnecessary. Interestingly, the lack of inflation also makes tightening unnecessary at this time. When it is convinced the recovery is on solid ground, it is expected to start raising rates gradually again. The current forecast assumes first round of tightening will begin later this year.

U.S. Housing Starts



Source: DRI*WEFA

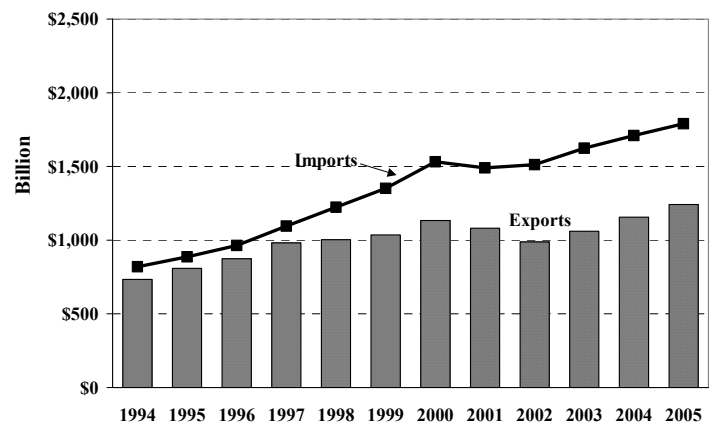
the drop in starts that year was a relatively small 4.4%. Growth resumed in 2001, however, as mortgage interest rates retreated. This is an interesting exception to typical housing behavior in a recession year. Usually, housing starts are one of the first victims of a faltering economy. A closer look shows that maybe housing's performance last year was not atypical. When the data is viewed on a quarterly basis, one sees all housing's strength occurred during the first quarter of 2001. This growth was so strong it actually masked the housing declines in the remaining quarters of the year. Surprisingly, housing starts jumped in the first quarter of this year. But this probably has more to do with the mild winter weather than economic factors. Housing starts follow relatively predictable seasonal patterns. Typically, as winter moves in, housing starts drop. To adjust for this, factors are developed and used to adjust the raw data to compensate for seasonal patterns. This is done so any remaining changes are mainly due to economic factors. The seasonal factor for housing achieves this by boosting the winter raw housing start data. But this winter has not been typical; it was the mildest on record. As a result, the decline in the raw data that usually took place did not occur. However, the raw data was increased by the seasonal factor, which is why housing starts were so strong in the first quarter of this year. Had the winter been more typical, U.S. housing starts would have been lower. The current forecast shows U.S. housing starts falling 1.9% both this year and next, then rising 5.3% in 2004, and 1.1% in 2005.

International: Many countries should stir from their respective economic slumbers in 2002. The global economy did expand last year, but just slightly. In fact, 2001's 1.5% increase in real GDP would be considered a recession by most international economists. Global GDP is forecast to rise 1.7% this year. While this is still relatively weak, it does show the economy is starting to heat up. This is the result of strengthening in all regions, except South America. The Canadian economy grew marginally faster than the U.S. economy in 2001 and avoided a recession. Both the U.S. and Canadian economies are expected to pick up speed

this year, but the growth gap between the two should widen. There are a couple of reasons the Canadian economy outperformed its U.S. counterpart last year and is expected to be stronger this year. First, the Canadian economy is less dependent on the high-tech sector than the U.S. As a result, it was

Housing: National housing starts are projected to slip from their recent lofty heights in both 2002 and 2003 before posting a mild rebound. The recent history of housing starts is interesting because its performance often defied logic. The recent string of housing start gains began in 1996. Soon after that economists were convinced that starts had reached a peak and would fall in the following year. But each year was stronger than the preceding one. This pattern continued to 2000, when preemptive policy tightening by the nation's central bank put upward pressure on mortgage interest rates. But

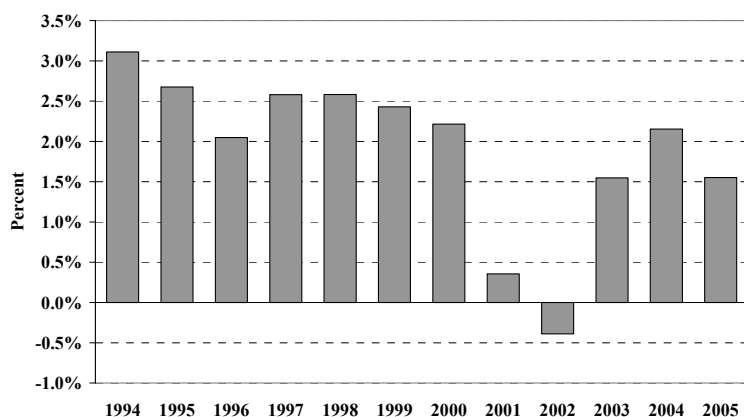
U.S. Imports and Exports



Source: DRI*WEFA

less affected by the global slump in information technology investment. Second, Canada's federal government and several of its provinces enacted tax reductions in early 2001, whereas the U.S. federal tax cuts were introduced later that year. It is anticipated that Mexico will stage one of the biggest turnarounds. The Mexican economy shrank 0.3% last year, but should increase 1.8% this year. Unfortunately, south of Mexico the economic situation is not as promising. After growing a meager 0.6% in 2001, the South American economy is forecast to shrink 0.4% in 2002. The aggregate economy of the four large European countries (France, Italy, Germany, and the United Kingdom) will actually grow slightly slower this year compared to last year (1.4% versus 1.7%), but there have been signs recently that it is on the upswing. If the world's economy has been asleep, then Japan's has been in a coma. And its prognosis is not encouraging. The Japanese economy is expected to shrink another 0.9% this year after contracting 1.2% in 2001. The Japanese government has undertaken policies to combat its chronic recession and results are expected in 2003. Across the rest of Asia, the economic outlook is brighter. Recent increases in exports from these countries bode well for their economies. Middle-income Asia (China, India, Indonesia, Malaysia, Philippine, Thailand, Fiji, Maldives, New Guinea, and Vanuatu) is anticipated to grow 5.5% this year and 6.5% next year. With all of its major regions expanding in 2003, the global economy should grow 3.6%--which is twice as fast as in 2002. Looking beyond next year, real global output should grow an average of 3.3% from 2004 to 2006. Real net exports should continue to be a drag on the U.S. economy. The U.S. real trade deficit should swell from about \$400 billion in 2000 to \$564 billion in 2003. The deficit is expected to shrink beginning in 2004, but progress will be slow. Specifically, the real trade deficit should be about \$530 billion in 2006, which is still much higher than in 2000.

U.S. Nonfarm Employment Growth



Source: DRI*WEFA

Employment: The labor market has quickly changed from one favoring workers to one favoring employers. This marks a significant change from the previous few years. One of the most interesting features of the 1991-2001 expansion was the surge in employment. During this time a couple of major milestones were achieved. First, the U.S. civilian unemployment rate slipped under the rate consistent with full employment in mid-1996 and stayed below through most of 2001. Second, the unemployment rate dropped below 4.0% in the fall of 2000. Under these conditions businesses found themselves

in the rare position of not having enough qualified job applicants. This trend began reversing itself in 2001. The job market steadily loosened that year, as evidenced by the unemployment rate that climbed from 4.2% in January 2001 to 5.8% by December 2001. It is interesting to see which sectors have been losing jobs. Manufacturing employment has been particularly hard hit; it shrank 4.2% in 2001. But it is not the only sector whose employment has suffered. Employees of help supply services (or temps) have also been hit hard by the recession. At their peak in 2000, temps accounted for fewer than 3.0% of total employment, but they have experienced disproportionate share of job losses. The size of these losses depends on how they are calculated. This sector accounted for a third of the jobs lost during the recession. On the other hand, when calculated from its September 2000 peak to its January 2002 trough, this sector's losses account for nearly half of the total jobs lost in the U.S. This number is higher because this sector began shedding jobs before the rest of the economy. After shrinking in both 2001 and 2002, total U.S. nonfarm employment is expected to rebound. Specifically, it is forecast to fall 0.4% this year, but rise 1.5% next year, 2.2% in 2004, and 1.6% in 2005.